



NEPC, LLC

To: Delaware Cash Management Policy Board
From: John Krimmel and Kevin Leonard
Date: July 23, 2019
Subject: Rule 144A Securities

Background

During recent discussions with the Liquidity and Reserve investment managers, a question arose as to whether Rule 144A Securities (private placement) could be held in the State of Delaware portfolios. The issue is not if Rule 144A Securities were permitted by the Guidelines, as Section 10.1.7. permits the securities (subject to liquidity constraints), but if the organization is a Qualified Institutional Buyer (QIB) as defined under the Securities and Exchange Commission Rule 144A.

Current Regulations

Under current regulations a QIB is an *institution* that owns and/or invests on a discretionary basis at least \$100 million in *eligible securities*. The SEC has a defined list of institutions that may qualify as a QIB if they meet the asset threshold. The list is very detailed and includes banks, investment companies, corporations, pension funds, etc. Absent from this list are state and local government entities (other than pension funds established by such bodies). Eligible securities are defined as those securities owned and invested that are not affiliated with the institution. The full list of institutions and definition of eligible securities as defined by the SEC (based upon their website) is appended to this memorandum.

Efforts by State and Local Governments to Expand the QIB Definition

Following the global financial crisis, many state and local governments became involved in the Money Market Reform efforts. As a part of their effort, they unsuccessfully petitioned the SEC to expand the list of eligible institutions to include their entities as a QIB. Several entities including the Alaska Permanent Fund have received an SEC no-action letter indicating that they are a QIB. The efforts to achieve this result, as we understand, were time consuming and expensive. It is our understanding that there is a current effort underway to have the SEC revisit the inclusion of state and local entities. We are attempting to determine who is spearheading the effort to learn how our clients can help support an expansion in the QIB entities.

Recommendation

Based on our discussion with OST Staff and Legal Counsel, we believe that divestment of Rule 144A securities occur until such time that they are deemed acceptable under SEC regulations. As such, we recommend adding in language to this effect in the proposed changes to the Guidelines.



Appendix – Qualified Institutional Buyer Definitions

Rule 144A provides that a “Qualified Institutional Buyer” (“QIB”) can be any of the following institutions, provided that such institution owns and/or invests on a discretionary basis at least \$100 million in eligible “securities” (defined in II below).

- (a) an **insurance company** as defined in Section 2(13) of the Securities Act of 1933 (the “Act”);
 - (b) an **investment company** registered under the Investment Company Act of 1940, acting for its own account or for accounts of other QIBs that are part of a *family of investment companies* (as defined in Rule 144A) which family of investment companies owns in aggregate at least \$100 million in eligible securities;
 - (c) an **investment adviser** registered under the Investment Advisers Act of 1940;
 - (d) a **corporation** (other than a bank as defined in Section 3(a)(2) of the Act or a savings and loan association or other institution referenced in Section 3(a)(5)(A) of the Act or a foreign bank or savings and loan association or equivalent institution);
 - (e) a **partnership** or Massachusetts or similar business trust;
 - (f) a **plan established and maintained by a state**, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees;
 - (g) an **employee benefit plan** within the meaning of Title I of the Employee Retirement Income Security Act of 1974;
 - (h) any **trust fund** whose trustee is a bank or trust company and whose participants are exclusively plans of the types identified in paragraph (f) or (g) above, except *trust funds* that include as participants individual retirement accounts or H.R. 10 plans.
 - (i) a **not-for-profit organization** described in Section 501(c)(3) of the Internal Revenue Code;
 - (j) a **dealer** registered pursuant to Section 15 of the Securities Exchange Act of 1934 (a dealer only is required to own and/or invest at least \$10 million in eligible “securities,” excluding securities constituting whole or a part of an unsold allotment to or subscription by a dealer as a participant in a public offering);
 - (k) a **bank** as defined in Section 3(a)(2) of the Act, a savings and loan association or other institution as referred to in Section 3(a)(5)(A) of the Act, or any foreign bank or savings and loan association or equivalent institution, acting for its own account or accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with it, and that has an audited net worth of at least \$25 million as demonstrated in its latest annual financial statements;
 - (l) a **business development company** as defined in Section 2(a)(48) of the Investment Company Act of 1940;
 - (m) a **business development company** as defined in Section 202(a)(22) of the Investment Advisers Act of 1940;
 - (n) a **Small Business Investment Company** licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958;
 - (o) any entity, all of the equal owners of which are QIBs.
- II. Eligible “Securities” — in determining the aggregate amount of securities owned and invested on a discretionary basis by an entity, the following instruments and interests shall be *excluded*: securities issued by issuers that are affiliated with the purchaser or, if the purchaser is an investment company, are part of that purchaser’s “family of investment companies”; bank deposit notes and certificates of deposit; loan participations; repurchase agreements; securities owned but subject to a repurchase agreement; and currency, interest rate and commodity swaps.